THE INTERNAL AUDITOR

A PERIODICAL OF
THE INSTITUTE OF INTERNAL AUDITORS, INC.

March 1945

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March 1945

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THE INTERNAL AUDITOR

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[*Expressions of opinions in* THE INTERNAL AUDITOR *by the editor and contributors are their own and are not necessarily endorsed by* THE INSTITUTE OF INTERNAL AUDITORS. *Articles are selected for their general interest to those in the internal auditing field.*]

VOL. 2 MARCH, 1945 No. 1

AUDITORIALLY SPEAKING

THE INTERNAL AUDITOR AND HIS PLACE IN BUSINESS

MANY interesting papers have been published within the last three or four years about the duties of the internal auditor and his position in the business life of a corporation. These papers make of him a composite creature and we deduce from their content that his early training has an affect upon the attitude he assumes toward his position and those duties which he stresses. All agree that he should have a good accounting training so that he is well grounded in accounting principles. While internal auditing may still have its roots in accounting, its real service to its company is in the realm of management control. The auditor's outlook upon a given set of circumstances may augment the accounting viewpoint. The accountant's purpose is to properly record transactions so the business history has continuity in accordance with certain principles. The auditor views the recorded work and seeks therein proper internal control; and to ascertain that the recorded information conforms

with management orders and that management is aware of the result of the compilation. The auditor is, therefore, primarily the eyes of management.

The development of internal auditing among business organizations has been facilitated and encouraged by the Public Accountants, and they have increased their reliance upon the internal audit and control functions, but only after very critical examination and not, however, to the extent that they curtail their own independence of action. The support from the public accountant has been largely the result of the additional responsibilities having been placed on them through legislative enactments.

Over the years the auditor has been gaining in importance in proportion to his usefulness to the Company and the old concept of checking the cash and related accounts is becoming more routine in nature. Today, more than ever, the auditor must devote his efforts to the proper interpretation and application of new laws being promulgated regarding wages and hours and to management regulatory directives.

There is a tendency, owing to the exigency of the times, for the internal auditor to become involved with the application of the termination, renegotiation and cancellation of contracts, and thus become so enmeshed with the details pertaining thereto that he actually does accounting work. Termination, cancellation or renegotiation is the problem of the chief accounting officer, and the company auditor is more concerned with the general effect on company affairs and the manner of and application of the adjustment.

The auditor should never lose sight of his principal objective, that of top management advisor. He should devote much of his effort toward observing the interpretation and application by operating departments of new laws promulgated by government regulatory agencies and of company policies as set forth in general orders issued by management. The systematic verification of accounting and financial transactions will always remain an important part of the duties of the internal auditor and in this connection he should refrain from partaking in the recording of such transactions to the extent that he is performing daily accounting tasks.

LOOKING AHEAD . . .

The day is past when management's decisions can be based on figures that are history rather than news. A business is headed for trouble if it must base today's decisions on last year's facts—or last quarter's—or even last month's! The successful business has—or can immediately get—current facts for current decisions.

To furnish management with *current* facts—and *more* facts—the progressive internal auditor devises new records . . . new systems . . . new techniques . . . new types of analyses.

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NATIONAL ORGANIZATION NOTES

THIRD ANNUAL CONFERENCE PAPERS

AS this issue of "THE INTERNAL AUDITOR" goes to press, it is believed that the *Third Annual Conference Papers* will be in the hands of INSTITUTE members prior to the receipt of this issue. The volume containing the papers is entitled "INTERNAL AUDITING NOW AND AFTER THE WAR." One copy will be furnished free to each member. Additional copies may be purchased at the price of $1.75 per volume.

YEAR BOOK

The 1944 Year Book which is furnished free to the membership should be in the hands of members shortly before or shortly after the receipt of this issue of "THE INTERNAL AUDITOR."

"THE INTERNAL AUDITOR"

The Publication Office of "THE INTERNAL AUDITOR" at 39 Atlantic Street, Stamford, Connecticut, has on hand a limited supply of the September and December, 1944 issues. Those members who may wish one or both of these back issues in order to complete the set for their library may obtain them at the price of $1.00 per issue.

INSTITUTE MEETING IN ITALY

We recently received word from INSTITUTE Member Major David B. Mathias that he recently enjoyed a meeting with INSTITUTE Member Pfc. Ernest B. White "Somewhere in Italy." Both Major Mathias and Pfc. White are members of the New York Chapter. Their meeting constituted a meeting of the FIRST Secretary and the FIRST Treasurer of the FIRST INSTITUTE Chapter established. Dave was Secretary and Ernest was Treasurer.

NOTES FROM SECRETARY'S OFFICE

Secretary Peter J. Buzanga advises that each member should have received the current INSTITUTE Brochure. Chapter Secretaries have a supply of the Brochures and a limited additional supply is on hand in THE INSTITUTE Secretary's Office.

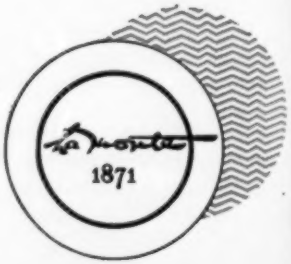
Members are urged to immediately notify the Secretary's Office of change in company affiliation. Changes of address for mailing purposes should also be promptly advised.

A few recent occurrences have indicated that it is not entirely

A SAFETY SUGGESTION

It is evident that there is a growing awareness among Internal Auditors of the need for *further safeguards* against defalcation by fraudulent alteration. » » This applies particularly to such accounting documents and records as Vouchers, Requisition Forms, Shipping and Receiving Authorizations, and Cash and Warehouse Records. » » May we suggest that La Monte Safety Paper, because of its widely recognized *protective properties*, may prove of value in this field?

GEORGE LA MONTE & SON
NUTLEY, NEW JERSEY



clear to the members of THE INSTITUTE that membership status may be retained in the event of a change in the nature of duties. Even retirement and entering into an entirely different field of endeavor do not disqualify a member from continuing his membership.

FOURTH ANNUAL CONFERENCE

At the time this issue goes to press it appears unlikely that THE INSTITUTE will be able to hold an *Annual Conference* of the type heretofore held. It is, of course, too early to arrive at a definite decision, but the travel restrictions currently being placed on such meetings, if continued, will bring about this result. In the meantime, THE INSTITUTE officers and directors are giving consideration to various plans. While the regular annual business meeting will be held in any event, it is possible that members will be asked to prepare suitable papers on Internal Auditing and related subjects so that these may be published and thus afford some of the benefits that have been available to the membership heretofore in the highly successful annual conferences of our three short years of existence.

NECROLOGY

It is with deep regret that we announce the passing of Mr. George H. Schuette. He was a member of Chicago Chapter and had been in the employ of Peabody Coal Company.

CHAPTER NEWS

NEW YORK CHAPTER

SINCE going to press, the popularity of the programs presented at the regular meetings of the New York Chapter has manifested itself. The opportunities for participation in the Panel Discussion presented to attending members have been enthusiastically received and the discussions of Internal Auditing in its detailed application have created the most lively meetings this correspondent has attended in a long while.

The November meeting discussed "The Scope of Internal Auditing of Technical Operations," and was led by Mr. James Chapman of Otis Elevator Co. Chairman and Messrs. J. Ernest Laurie of Prudential Insurance Co., Edward J. Novotney of Consolidated Edison Co. and Joseph J. Schofield of North American Phillips Co. The industries represented and their different approaches to the subject gave all those attending some worthwhile thoughts for consideration. The Chapter was honored by the attendance of Mr. A. H. Wilson of Canada Packers Limited, Toronto, Canada.

The January meeting held at the new meeting place, the Hotel Sheraton, covered "The Internal Audit of Disposition of Production Inventory." The Chairman for the evening was Mr. Robert B. Milne of Columbia Engineering Company and the Panel members were Messrs. Bradford Cadmus, of Standard Brands Incorporated, James J. Wilson of Kennecott Copper Co. and Edward J. Boehmer of Columbia Aircraft Corporation. This meeting was attended by two of our California friends Walter B. Meigs and J. F. Welch of Lockheed Aircraft Corporation.

Mr. William J. Farnan, President of the New York Chapter, deserves the approbation of all members for his enthusiasm and ability in handling his new and difficult task.

Relations with other Professional organizations were further agreeably strengthened when Curtis T. Atkisson of Ebasco Services, Inc. and First Vice President of THE INSTITUTE, recently addressed the Brooklyn Chapter of the National Association of Cost Accountants on the subject of "Internal Checks and Controls vs. Internal Auditing." The address was very enlightening and stressed the real value of Internal Auditing as a managerial technique.

The topics to be discussed at the March and April meetings of the New York Chapter will be "Auditing of Disposal of Assets other than Goods Produced for Sale" and "The Use made of Internal Audit Reports," respectively. The May meeting will be devoted to discussion and review of all topics which were presented at meetings during the year.

DETROIT CHAPTER

AT the December meeting, Mr. Erwin H. Blum, Supervisor of Internal Audits of Vickers, Inc., discussed the audit of sub-contractors claims and presented through case studies, the procedures followed by his company in the verification of such claims. A lively discussion on contract termination problems followed the talk.

Mr. Earle H. Cunningham, General Auditor of General Motors Corporation and Director of THE INSTITUTE OF INTERNAL AUDITORS, was the speaker at our January meeting and gave a very interesting talk on Staff Training. He outlined the requisites of staff training and the methods by which it may be accomplished. Interest in this subject was evidenced by the attendance of some 70 members and guests.

Mr. James W. Parker, President and General Manager of The Detroit Edison Comany, will address the February meeting on "What Management Expects from its Staff." This is the first time that the Detroit Chapter has had the privilege of a representative of top management as the guest speaker. Manifestation of the interest in this meeting indicates a large attendance and the presence of several top executives of business firms in Detroit.

One of our members, Mr. B. F. Jackson of Price, Waterhouse & Co. spoke at the January meeting of the Detroit Control of the Controllers Institute of America.

The Detroit Chapter commemorated its second anniversary at the January dinner meeting, at which time Mr. John G. Ivers, first President of the Chapter, delivered the salutation and presented the anniversary cake in token of the occasion.

CHICAGO CHAPTER

THE Chapter has had a number of successful programs through talks made by members of the Chapter. The February meeting will be addressed by Gordon G. Crowder, one of the organizers of the Chapter who will discuss the subject, "Auditing of Property Accounts."

J. F. Blair and C. H. Blanchar, Chicago members, recently addressed a meeting of the Office Management Association in Chicago on "Internal Auditing."

LOS ANGELES CHAPTER

MR. M. A. Samuelson, Assistant to the General Auditor of Consolidated Vultee Aircraft Corporation, in charge of auditing of records of sub-contractors in connection with Contract Termination Claims, delivered a most interesting talk on the subject of Field Auditing of Contract Termination Claims at the January meeting.

Members of Los Angeles Chapter were most pleased to welcome the return to Los Angeles of the Chapter's first President, John J. Gorman. Mr. Gorman is also a Director of THE INSTITUTE. Some months ago he left Los Angeles to join Montgomery Ward in Chicago, but has now returned to accept a position with North American Aviation, Inc., Good luck, John!

PHILADELPHIA CHAPTER

AT our February meeting, Mr. Jerald S. Hanks, Assistant Comptroller of The Lehigh Coal & Navigation Company will speak on the internal audit procedure of that company.

At the March meeting, Mr. James P. Miller, Jr., General Auditor of The Atlantic Refining Company will speak on the subject "Co-operation between the Internal and External Auditor."

DAYTON CHAPTER

THE Dayton Chapter will celebrate its FIRST birthday at the February meeting. During that year the membership has grown from 10 to 17 and, with a splendid list of prospects to work on, the second year should witness even more rapid growth.

The January meeting was devoted to a discussion of "Audit Records and Reports" and produced the largest meeting attendance for the current year to date, a mark which however will probably be broken at the February meeting.

On February 20, many Dayton Chapter members will greet Mr. A. H. Romer, Assistant Secretary and Internal Auditor for Vickers Incorporated and a member of the Detroit Chapter, who will be the principal speaker at a meeting of the Dayton Chapter of the National Association of Cost Accountants.

CLEVELAND CHAPTER

CLEVELAND Chapter now has 25 Members, 3 Associate Members and 6 Junior Members. The Chapter recently welcomed into membership the following:

E. Ross Mateer, The Youngstown Sheet and Tube Company, Stanley Gray Harris, Elmer J. Norst, Guy M. Turner, American Steel and Wire Company.

At the January meeting, Mr. E. Ross Mateer, one of our newer members presented a most interesting paper on "Duties of the Internal Auditor as to the Reconciliation of Physical and Book Inventory." The President of the Cleveland Chapter, J. P. Long of Cleveland Cliffs Iron Company will address the February meeting and Chapter Governor L. T. Wold of American Steel and Wire Company will address the March meeting on subjects to be announced later.

TORONTO CHAPTER
(Canada)

THE 1944-1945 season of the Toronto Chapter is well under way and has all indications of being a very interesting and educational season. The regular monthly meetings are being well attended and considerable material has been presented. The Chapter is growing steadily; the membership now consisting of twenty-four members, two associates and one junior with four applications pending. It is quite evident that we have members who are qualified to present papers and carry on discussion periods which have been of considerable value to all present.

The speaker for the November meeting was Mr. J. B. Metzler, Chief Executive Regional War Labour Board for the Province of Ontario; his subject—Wage Control and Ancillary subjects. This was a very timely subject and was followed with very keen interest.

The December meeting covered defalcations, their detection and prevention. This subject was presented by four chapter members, Messrs. A. S. Cooke, K. L. MacArthur, G. Appleton, S. Whistance-Smith.

As our thoughts turn to the new year and taxation problems, our speaker for the January meeting, Mr. Lancelot J. Smith, C. A., selected a subject which created considerable interest and discussion; the subject being, "Some Aspects of Income Taxation."

The Chapter has arranged a form of clearing house for the collecting and transmitting of audit problems. This undoubtedly, will stimulate considerable interest.

Our *First Anniversary* meeting will be held on Friday evening, April 27. Associate member A. Ross Browne, C. A. and member J. F. Kidner will discuss the subject "Co-ordinating Internal and External Audits."

SAN FRANCISCO FORMS CHAPTER

MEMBERS will be happy to learn that a new chapter was formally organized and welcomed into THE INSTITUTE Chapter family during February, 1945

On February 7, 1945 the Members in the San Francisco area held an organization meeting. Actual Chapter status was attained on February 19th, through approval of the Board of Directors.

The elected Officers and Governor of the new Chapter are as follows:

President: F. H. ELLIOTT
California Packing Corporation

Vice President: ARTHUR H. KENT
Standard Oil Company of California

Secretary: J. F. WEST
Rheem Manufacturing Company

Treasurer: C. S. HENSON
Golden State Company, Ltd.

Governor: ELMER R. SMITH
Joshua Hendy Iron Works

TOTAL CHAPTER MEMBERSHIP 18

The new Chapter, the ninth in our chapter progress, is the result of a great deal of effort and planning on the part of local Members. Preliminary meetings were held at which the aid of all local Members was enlisted and methods of obtaining the required number of Members were resolved. The interest of the local Members and the degree of success of this campaign are found in the initial chapter membership. F. H. Elliott, California Packing Corporation, headed the organizational activities and is to be congratulated for the results attained.

From the manner in which the Members responded in the San Francisco area and the indicated interest in establishing a Local Chapter there is no question but that we will hear a great deal from this Chapter in the future. Meetings have been planned for the second Wednesday of each month at the Alexander-Hamilton Hotel.

EDITOR'S NOTE: Members everywhere can be of help to the new Chapter by sending to the Chapter Secretary the names of friends or business acquaintances located in the San Francisco area who are believed to be prospective Members.

REPORT OF CHAPTER ACTIVITIES COMMITTEE

CHARLES J. HILL, Chairman

CARRYING on from where Mr. Earle H. Cunningham left off, the Committee reviewed all replies by the Chapters to the questionnaire covering activities of the year 1943-44. Based on the information in these replies, a memorandum was prepared and sent to all Chapters setting forth the principal points which might be of value to Chapters in determining future policy, administration, etc. New Chapters will be provided with this information as they are formed.

Arrangements were completed for the exchange between all Chapters of the monthly bulletins issued by each Chapter. Notification procedure between Chapters and the Chairman of the Editorial Committee was co-ordinated in an endeavor to obtain advance publication in "THE INTERNAL AUDITOR" of all Chapter meetings and papers of general interest. A Regional Meeting of Middle West Chapters was under consideration but this was postponed indefinitely pending the easing of travel restrictions.

Future plans include visits by the Chairman to nearby Chapters and the obtaining, in due course, of reports from each Chapter on activities, experiences, problems, etc., of the 1944-45 season.

CHARLES J. HILL, Second Vice President of THE INSTITUTE, Governor of the Chicago Chapter (he was its first President) and Chairman of the Chapter Activities Committee, is a product of the Chicago Public School System. After starting with The Peoples Gas Light and Coke Company of Chicago in a very junior capacity, conscientious work by day and the study of accounting by night at Walton and Northwestern University, soon brought him to the forefront and in 1928 he was elected Auditor of that company. He has held the position ever since and is keenly interested in the furtherance of auditing as a profession. Among his hobbies, German Shepherd dogs take first place and he occasionally exhibits "Foldina von Chicagoland" at the better dog shows.

CHAPTER MEETING DATES AND PLACES

THE following list of meeting dates and places has been compiled for the benefit of itinerant members of THE INSTITUTE:

Chapter	*Meeting Date*	*Meeting Place*
NEW YORK	April 10, 1945 May 22, 1945	Hotel Sheraton
DETROIT	*Fourth Tuesday* at 6:30 P. M.	Wardell-Sheraton Hotel
CHICAGO	*Third Tuesday* at 6:30 P. M.	Hotel Continental, Tropical Room
LOS ANGELES	*Last Wednesday*	Scully's Cafe, 4801 Crenshaw Blvd.
SAN FRANCISCO	*Second Wednesday*	Alexander-Hamilton Hotel
PHILADELPHIA	*Second Monday*	Engineer's Club, 1317 Spruce Street
DAYTON	*First Wednesday* at 7:30 P. M.	Gas and Electric Building, Room 302
CLEVELAND	*Second Wednesday* at 6:30 P. M.	Hotel Hollenden
TORONTO	*Last Friday*	Royal York Hotel

CHAPTER DIRECTORY

Chapters	*Presidents*	*Secretaries*
New York	WILLIAM J. FARNAN *c/o General Baking Company* 420 Lexington Avenue New York, N. Y.	SAMUEL P. SMITH *c/o Isthmian Steamship Lines* 71 Broadway New York, N. Y.
Detroit	CHARLES J. GHESQUIERE *c/o The Detroit Edison Company* 2000 Second Avenue Detroit, Michigan	HARRIS R. SYMES *c/o The Detroit Edison Company* 2000 Second Avenue Detroit, Michigan
Chicago	JAMES B. PARKER *c/o International Harvester Co.* 180 North Michigan Avenue Chicago, Illinois	FRANK W. LENNON (Name legally changed from FRANK W. BENEDETTO) *c/o The Pure Oil Company* 2010 Pure Oil Building Chicago, Illinois
Los Angeles	HERBERT G. KIMBALL *c/o Lockheed Aircraft Corporation* Box 551, Factory B Burbank, California	EDMOND J. HALLAHAN *c/o Consolidated Vultee Aircraft Corporation* Vultee Field Downey, California
Philadelphia	WALTER K. SMITH *c/o The Sun Oil Company* 1608 Walnut Street Philadelphia, Pa.	FRANK M. FISHER *c/o The Lehigh Coal & Navigation Company* Fidelity Phila. Trust Building Philadelphia, Pa.
Dayton	ROBERT R. CRAWFORD *c/o Delco Products Division General Motors Corporation* Dayton, Ohio	FRANK T. SHERLOCK *c/o The National Cash Register Co.* Main & K Streets Dayton, Ohio
Cleveland	J. P. LONG *c/o Cleveland Cliffs Iron Company* 1460 Union Commerce Building Cleveland, Ohio	DANIEL H. JOHNSON *c/o Pickands Mather & Company* 2000 Union Commerce Building Cleveland, Ohio
Toronto	ARTHUR J. E. CHILD *c/o Canada Packers Ltd.* 2200 St. Clair Avenue West Toronto 9, Ontario, Canada	WILLIAM J. L. TOWNSEND *c/o Canada Packers Ltd.* 2200 St. Clair Avenue West Toronto 9, Ontario, Canada

SCOPE OF INTERNAL AUDITING

OF TECHNICAL OPERATIONS

(A summary of a panel discussion at the New York Chapter meeting November 20, 1944)

Discussion Leader: MR. J. D. CHAPMAN, Otis Elevator Co.

Panel Members:

MR. E. J. NOVOTNEY, Consolidated Edison Co. of New York, Inc.

MR. J. J. SCHOFIELD, North American Phillips Co., Inc.

MR. J. E. LAURIE, Prudential Insurance Co.

(A) "What is your understanding of auditing of technical operations and what does it cover?"

Mr. Novotney developed the thesis that while an auditor cannot be expected to have the particularized knowledge to judge the ability, efficiency, and accomplishments of highly developed technical and specialized operations, nevertheless he should have sufficient general knowledge of his concern's organizational set-up, and the scope of the functions of the various technical departments to be able to judge their general over-all efficiency by analyzing the end results. He should also assure himself that the broad aims of management as originally intended are being carried out by the various departments and their respective technical operations. The measure of their efficiency would be reflected in the books of account, to the extent of their conformity with previously established standards.

Mr. Schofield, on the other hand, felt that auditors could not adequately fulfill their responsibility to Management without going beyond the actual end results as reflected in the books of account in order to see what lies behind such figures. This would require analysis of the technical operations in the field in an endeavor to check current operations, so that past results could be correctly interpreted. In addition, it would mean the testing of controls over technical operations through observation, and might well lead to the installation of new controls where none previously existed.

Mr. Laurie inclined towards the first point of view, feeling that the auditor should not go beyond his own field of knowledge in judging the efficiency of the technical operations. Instead, he should check the results of these operations as shown in the books of account in order to ensure that the proper controls have been applied within the particular scope of the technical operations being audited.

After expressing their own views, the panel members participated in a general group discussion of the question, answering further queries from

the floor. Subsequent discussion indicated that possibly the difference in opinion as to the scope of the auditor's attempt to audit technical operations was not so great as might be judged from the original comments. Among the matters of more or less general agreement were the following:

(1) The auditor should satisfy himself that necessary controls over technical operations are being maintained in accordance with the desires of Management, and that departures from established standards are fully investigated and reported, so that Management can take the proper corrective measures.

(2) Field examination and observation of technical operations is desirable and necessary to supplement analysis of past results revealed in the books of account. Field analysis is essential to uncover certain factors which would otherwise never be revealed in the books of account.

(3) While the auditor may not qualify as a technical expert, and therefore cannot be expected to judge correctly the efficiency of particular technical operations, through the application of common sense principles he should be in a position to judge over-all results of the operations, and if necessary to devise additional controls where it is felt that results are not up to standard. However, it was pointed out that in attempting to set up additional controls, the auditor might well have to call on technical experts to supplement his own common-sense approach to the technical operation.

(B) **"What do you consider to be the most important aspect, from a financial standpoint, of the operation of the Production Control Department?"**

Mr. Schofield expounded his belief that auditors must look behind the figures. For example, he pointed out the weakness in being satisfied with inventory results simply because they balanced with the control figures. In addition the auditor should satisfy himself that there were no excessive quantities of materials included in the inventory in relation to current production requirements, in order to eliminate from the financial statements any fictitious values representing obsolete items. Furthermore, scheduling of production and purchase of raw materials should be covered by adequate controls, especially in view of present day conditions, such as contract termination and frequent changes in engineering design of multi-part finished products. Failure to establish and check such controls might easily result in inventory investments being improperly reflected in the financial statements.

(C) **"Lacking the technical knowledge to make conclusions, how can an auditor base his findings by checking the results of reviews and inspections performed by other departments?"**

Mr. Novotney illustrated his answer to this question with the example of the specialized "inventory engineering" department, whose function was to inspect actual installations of capital additions. By referring to the records of this technical department, and through a common sense analysis of the

facts at hand, the auditor could satisfy himself that the capital expeditures reflected on the books of account were in order, even though the technical operation was not checked while it was in progress. It was also pointed out in subsequent discussion, that authorizations for such expenditures would have been made as a protection to the company's interests, and these authorizations would likewise be subject to the auditor's review.

(D) "What special training or experience do you consider necessary to qualify the internal auditor for the work of auditing technical operations?"

Mr. Schofield stressed the traits of common sense, tact, and the ability to draw out people in conversation, as well as the capacity for analytical thinking. Illustrating his points with experiences in the field, he developed the idea that even in the most technical fields, an auditor can do much through plain common sense and a knowledge of cost accounting principles to investigate, correct, and even initiate controls over production processes, without being an expert in the particular operation. Along these sanlines, one of the members commented as follows, "Based on our experience, no great technical knowledge is necessary other than a wide awake, resourceful individual with a certain amount of initiative and common sense."

(E) "Conclusion."

In summing up the tentative conclusion to be drawn from the discussion, Mr. Chapman said, "It seems to me we have decided an auditor can probably check a technical standard, but I think we have also decided that a technician has to set the standard."

ARTICLES OF INTEREST

TO INTERNAL AUDITORS

A. A. BUZZI, Chairman of "Digest of Other Publications Committee" directs attention to the following articles of interest

JULY 1944—"The New York Certified Public Accountant"

Subject: **Contract Termination**—Presentation of Statement of Costs.

By: **JOSEPH J. WAGNER, C. P. A.,** now serving with the U. S. Army in the Cost & Price Analysis Branch of the Quartermaster Corps.

Mr. Wagner explains the use of the total cost versus the inventory method of contract termination. Under the inventory method, cost includes the dollar value of various classes of inventory, administra-

tive expense, and other costs, to which is added the contractor's profit, if any. Under the total cost method, all of the contractor's own charges incurred on the terminated contract to date of termination for both completed and uncompleted portions of a contract are included in the statement of costs. Allowance for profit applicable to these costs is added and deduction is made for the selling price of completed units. The advantage of each type of contract termination are explained in this article.

OCTOBER 1944—"The New York Certified Public Accountant"

Subject: **Internal Audit Reports.**

By: **LAWRENCE R. SCHMIDT, C. P. A.,** presently associated as Supervisor of Audits with Bendix Aviation Corporation, Englewood, New Jersey. He is a member of **The Institute of Internal Auditors.**

Mr. Schmidt very adequately covers the need for standardization of the internal audit reports. He also gives ten rules which should be considered in the preparation of reports.

JANUARY 15, 1945—"N. A. C. A. Bulletin," Section I.

Subject: **Costs on Terminated War Contracts Under Joint Termination Regulations.**

By: **M. J. FAHEY,** Assistant General Works Accountant, Allis-Chalmers Manufacturing Co., Milwaukee, Wisconsin.

This article covers basis of settlement—Contract Settlement Act of 1944; costs as basis for negotiation; standard claim forms; methods of claim presentation; percentage of completion basis; costing methods; material, labor, and overhead costs; settlements on total cost basis, including subcontractors' claims; post-termination expense; general, administrative, and distribution expenses; excluded costs, common items; loss on special facilities and profits; over-all limit on settlements; consolidated termination program; direct settlement plan; pre-termination agreements; assistance from government offices; and preservation of records.

THE INTERNAL AUDITOR'S CONTRIBUTION

TO CORPORATION TAX PROBLEMS*

By T. C. DAVIS

YOU will not be required to listen to a technical discussion; this talk is nothing more or less than a general resume of my impressions—gained from experience and observation—of the relation of the internal auditor to corporate tax problems.

In assimilating what is said here please bear in mind that administrative organizations vary greatly from company to company—and that the scope of work and responsibility of the internal auditor will differ in response to the type of administrative organization. This is not news to you, but I feel that a statement of it is essential to an orderly approach to my subject. For instance, I have in mind one old and rather large corporate organization where the administrative organization charges the internal auditor with the whole responsibility in handling tax matters. At the same time I can recite scores of corporations, equally large and prominent in their line where the internal auditor is not conscious of any contact of responsibility in respect of corporate tax problems. I should like to mention that in these latter cases there is a contact and a responsibility whether the internal auditor is conscious of it or not, and the responsibility is usually discharged in a most effective manner. My theme turns around just such situations. My comments from an organization concept under which the internal auditor is charged with the duty of a continuing audit of accounting transactions for the purpose of safeguarding corporate property and obtaining observance with rules of procedure that are intended to govern the accounting effort and to help in safeguarding property. You know also that there are corporations without number not large enough to have a separate auditing department or a separate tax department. You will have to use your imagination to fit my remarks and such situations together.

The internal auditor's position within a corporate organization is not peculiar but it is unique; unique in the sense that recognition of his work seems to decrease in direct proportion to the quality of his performance. These two op-

*A paper presented at the Nov. 1944 meeting of the Philadelphia Chapter.

posites travel in two directions, and when quality of performance reaches 100 the auditor must be watchful to avoid being dropped from the salary roll. Upon reaching the ultimate in performance the auditor works to "hold the line" doing such things as studying ways to do the same quality of audit job with less interference with operating and other administrative effort. He will try to train his successor and staff more thoroughly; he will try to cut down administrative cost by all means available, he will try to educate the staff to a better concept of operation needs and operating reactions, he will throw opportunity in the way of likely staff members to condition them for assuming more responsibile positions, even outside his department, if occasion should arise. In other words he pushes with all energy to consolidate and round out the quality of performance that I have described as standing at par or 100. And what happens? He does his job so well—his contacts with other departments are so satisfactory—that we overlook him entirely. We completely forget that he is on the job, we have nothing to remind us that he is there or to cause us to remember what would be the result if he were to take French leave.

I maintain that an understanding of the internal auditor's contribution to solving corporate tax problems must follow an understanding of his contribution to corporate management problems in general. In the great majority of cases you will not find a clearly outlined course of action that the internal auditor is expected to follow, which at the end can be cast up as having solved or assisted in solving a tax problem. Nonetheless, the internal auditor does help in handling these problems, and the strange thing is that the more help he gives the less likely are we to recognize that he is helping. To repeat, the more thoroughly he does his job the more certain he is to be forgotten. Therefore, I think it an excellent idea that all of us pause occasionally—the internal auditor and other corporate management men—and remove the curtain from around the internal auditor's performance. At each such pause let us look at that performance by analysis and we shall see that the internal auditor really does contribute to the successful effort of all company departments, and at the same time we shall derive a better understanding of how he does it. We don't stop, look and listen enough in our company, and I'll wager that most of the companies represented here tonight fall into the same practices.

You know, in dealing with an internal revenue agent at time of audit of accounts underlying a tax

return there is no substitute for confidence of the agent in (1) the system of accounts, (2) the control exercised over the system, and (3) confidence in the person or persons with whom dealing must be had in order to accomplish the audit. When you recognize that the system of accounts and control over that system is beyond the tax department's function you will begin to see the direct relation of the internal auditor to the tax auditor. True, the tax department representative must generate confidence at the point of personal contact but there is a limit to what the corporate tax man can do to generate confidence in a system of accounts or control over that system. It is at this point that the internal auditor's organization—through the continuous audit—makes a real contribution to the generation of confidence in the accounts and the results disclosed by accounts. Tax auditors are human; they would rather rely upon the the accounting results of a poor system ably administered and subject to competent audit than a good system with poor audit. From my experience, an average tax auditor feels that if he has a grasp of the fundamentals of system the internal audit organization gives him the assurance that he needs to move around and outside of a "transaction audit." He can then approach his examination on the basis of analysis of specific accounts for the purpose of preparing an acceptable audit report and need not examine routine transactions to satisfy himself that the accounts are honestly kept. Here again, the tax auditor is human; he knows that an internal audit organization having no part in or responsibility for recording transactions, but charged with the duty of auditing the recording, constitutes a contribution to honest and accurate accounting upon which he can rely. The tax auditor rarely ever sees the internal audit organization. He doesn't have to see it, —his confidence is invoked by knowledge of its existence and upon how it functions in relation to the function of recording transactions. Does one physician have to see another physician to have confidence in each others work? Does one lawyer have to see another as a sole basis of confidence in the work of each other? Now, can you estimate the value of the internal auditor's contribution to handling corporate tax problems from this general approach? You can't; that contribution is tremendous but it cannot be evaluated. I know that the contribution is very real in our own organization; I know that it can't be evaluated, and I know that we forget to give it the recognition it deserves. I imagine this situation is generally true. I know that the tax auditors

who have examined our accounts up to this time have confidence in the honesty and meticulous accuracy involved in account keeping and that this confidence is in no small part due to the knowledge that there is a continuous audit carried on by a competent internal audit organization having no responsibility for recording transactions. In contrast, imagine a situation under which the tax auditor did not have that confidence and we were obliged to submit to a transaction audit. Think of the time that would be consumed and the inconvenience to both the Government and ourselves. I am not concerned that any such thing will ever come to pass because the internal audit organization is going to continue to perform in such manner that there is no exposure to the extreme of a transaction audit. In doing well its every-day job of continuous audit, the internal audit staff makes itself felt in the work of handling corporate tax problems.

Let's consider for a moment the effect upon a corporate tax department's approach to its responsibility in the light of the existence or non-existence of a competent internal audit organization. All of you know that the corporate tax man is a technician—the trend of corporate tax law has made him that. He must try to fit the income results and the maze of legal tax requirements together and file a tax report. He knows that every time a figure is placed on a tax form—or not placed thereon—he subjects a corporate officer to a charge of fraud or to a charge of non-compliance with law or regulations involving penalty of one kind or another. He must keep eyes and ears open and mind clear in the hope that his acts will not bring a penalty upon the corporation and great disappointment in the quality of his own work. Does it require much imagination to see how much dependence the tax man places in the work of the internal audit organization. Can you grasp the boost to the tax man's confidence in the figure results that he must use when he knows that there is a constant check upon the recording by a competent internal audit staff? Can you grasp the contribution to the tax effort from the mere fact of freeing the corporate tax man's mind and energy for dealing with the pure tax aspects of taxes? Here again, let me say that the average tax man does not tell the internal auditor often enough of his reliance and dependence, but the tax man should be ashamed of himself.

I know of one situation—a very large corporation having large investment in properties subject to depreciation. In the thirties—with the advent of meticulous detail being required for the first time by

the Bureau of Internal Revenue as a basis for depreciation allowance—the internal auditor undertook to make historical study of the property investments and to prepare annually the depreciation schedules for use by the tax department. I believe that situation continues today. I was not present at any of the discussions with Bureau of Internal Revenue personnel,—but the fact that these schedules were prepared by an audit staff having no responsibility for the outcome of tax negotiations must have impressed Bureau personnel. I believe that under such circumstances each one of you—as a tax auditor—would have been persuaded subconsciously if not consciously—as to the "factual rightness" of the data presented.

In one company having a large investment portfolio as well as large operations—this does not happen to be the Du Pont Company—the internal auditor prepares annually for the tax department a detail schedule showing the investment in each stock or bond—changes in the investment during the year—and the income from each such investment. Think what a help that is to the tax department. True, it is an analysis job and after the form is drawn that suits a particular purpose any junior accountant can carry it through. But, responsibility for its "factual rightness" is removed from the tax department and that is a big help.

Another actual case that you may find interesting. One very large company—ocean telegraphic cables and radio communication—does business in many foreign countries. The internal auditor prepares annually a statement of gross receipts *by cable or radio office*—just think of that—that serves as a basis of work through to net income in each foreign country or taxing jurisdiction. This data is important not only for tax purposes in each foreign taxing jurisdiction, but for credit of foreign taxes against the U. S. tax in these United States.

I want to take up a more specific item; namely, inventory. It is customary for the internal audit staff to exercise some rather clearly defined responsibility in respect of inventories. Also, inventory plays an important part in the determination of taxable income. In most cases the inventory taking procedure is designed by the internal auditor, and his staff usually supervises the taking of the physical inventory. It has been my experience that we either have no trouble or much trouble with tax auditors in connection with inventories. When the tax auditor is convinced that the inventory physical count was made by competent persons following proper method, and the valuation of such

inventory followed the plan consistently used, then no trouble ensued. But, the moment suspicion is turned upon the inventory you can't stop the flow of trouble. That has been my experience. Now where do you think we must turn if as and when an inventory has to be sustained? More than likely to the internal auditor. Certainly the tax man can't make an affidavit that he supervised the taking of the inventory, or that he personally satisfied himself that each item of inventory was priced in accord with adopted practice consistently followed. In connection with this specific item—inventory—you can see clearly that if you do your job well the tax man may never have to call upon you—and that if he does have to call upon you he needs your help badly and it is ten to one that you are the only one competent to save the issue. Having regard for the tremendous amount of detail involved, the internal audit staff makes a real contribution to tax work if it should do nothing more than keep inventory straight.

My last item—as such—is to make quick reference to the corporate tax man's involvement in the ever present issue of capital expenditures vs. revenue expenditures—and to draw the internal auditor's relation to this problem into the open. In this sense I want to focus upon the item of repair expense vs. plant additions, as a means of avoiding talking about something specific in such a general way as to be confusing. I spoke earlier in a manner that suggested a constant threat of transaction audit. The transaction audit often aproaches reality in connection with repairs vs. plant additions. The tax auditor recognizes the opportunity in this field for play of individual judgment and discretion in the making of entries, and it has proven a fertile field for adjustment to taxable income. The internal auditor exerts his silent influence and assists in settling these issues because he is recognized at the watchdog of the application of accounting rule. The tax auditor recognizes that the internal auditor has opportunity to detect an improper application of rule as regards capital expenditure vs. revenue expenditure when taking inventories and when examining costs. The tax auditor is therefore more likely to first decide the adequacy of the rule and rely upon the internal auditor watchdog for strict observance of rule than he is to pursue the matter wholly by transaction audit.

What I have attempted to bring out is that the very nature of the internal auditor's job and the efficient manner in which that job is ordinarily carried out stand as continuous and substantial contributions to the handling of corpo-

rate tax problems. The internal auditor is completely divorced from the necessity of exercising judgment in matters of original entry to accounts. He enjoys an independent status within the corporate organization. Does it not follow that any examination of corporate accounts by any person for almost any purpose would rely to the full extent reasonable in the circumstance upon the work already done by the internal audit staff—namely keeping watch over observance of accounting rules in recording of transactions?

While I have spoken very generally I am certain of what I said. I know from first-hand experience and observation that the internal auditor exerts an influence upon handling corporate tax matters that is generally neither obvious nor apparent; that this influence is far too often taken for granted, and that upon analysis and reflection the "influence" is translated by understanding alone into positive assistance in the solution of corporate tax problems. This nonrecognition is nothing new to you gentlemen. As I said in my opening remarks the better you do your job the more likely we are to forget you. I shudder to think what would happen if you just stopped doing your job; what a shock it would be to us to call upon you under pressure of imperative need and not find you there. We don't have to concern ourselves; it is your nature to be always on the job at top efficiency.

PROMOTIONS

Again we offer our congratulations to John B. Thurston who recently earned the title of Treasurer and Director of Industrial Engineering in Transcontinental & Western Air, Inc. John is known as the father of THE INSTITUTE, was its first President and is now a Director. Nice going, John!

Philip G. Wharton, Vice President of the Philadelphia Chapter, has been made Vice President of The Atlantic Refining Company. Previously, Mr. Wharton was General Auditor. Congratulations and good luck, Philip!

Our congratulations are also extended to James P. Miller of The Atlantic Refining Company upon his promotion to General Auditor from Assistant Auditor.

T. G. Harper has recently been receiving congratulations from his friends in the New York Chapter upon his election to a Vice Presidency of G. R. Kinney Company, Inc. Our congratulations to you, Mr. Harper!

MODERN INTERNAL AUDITING

AND ITS RELATIONSHIP TO INDUSTRIAL ENGINEERING*

By JOHN B. THURSTON

FACTORS LEADING TO INEFFICIENCY

THE American war effort has bred both efficiency and lack of efficiency in American industry. Let us examine this paradox.

Lack of efficiency has resulted from a number of things such as the psychology of "Damn the torpedos; full speed ahead;" many millions of men and women were put to work on jobs completely new to them; for the first time many manufacturers produced products they had never produced before; the fear that unless businessmen maintained voluminous records, they would be penalized severely by the government; the amount of red tape that the government imposed on business; in many instances men have stood still unwittingly allowing their companies to outgrow them; the rather prevalent psychology of "Why worry about spending the money? The government pays for it anyway."; and this is most important, excess profits taxes have warped the thinking of many, many executives into a point of view where they say, "Sure, spend the money. Uncle Sam pays eighty percent of it. It only costs us a mere twenty percent."

All of us should be concerned with this situation, since it might lead to an inefficient America. We might find ourselves on the same economic rocks of inefficiency that wrecked much of Great Britain's economy in the past twenty or thirty years. Let us guard against it.

FACTORS LEADING TO EFFICIENCY

The picture we have just painted is a pretty black one. But if that were the only side of the picture, we would not be on the Island of Leyte in the Philippines today, nor would we be on the so-called "Holy Soil" of Germany. The paradox is that in spite of all the inefficiency in our war effort, America has produced the goods. And it has produced them in vast quantities at increasingly lower costs. Despite the inefficiency in many companies and in many cir-

*Briefed from original delivered to N. A. C. A. Lehigh Valley Chapter meeting November 17, 1944.

cumstances, efficiency has prevailed in other companies and in many other circumstances. Thus, American production is winning the war—efficient American production. This efficient production has resulted from many things: over the years immediately preceding the war—yes, and during the war years—management techniques have been improved; new materials have been introduced permitting cheaper, faster, or more efficient production of goods than was possible with older material; the development of new production machines which do the job of five or ten machines before the war; the developments in chemistry, such as electronics being put to work on the production line sorting good from bad products—making inspection scientific in many circumstances where it was only empirical before; the billions of dollars poured into new facilities—buildings like Willow Run, and the mammoth aircraft factories on the west coast, with which buildings, management has been able to establish production lines and proper plant layouts which would have been impossible in old, outmoded factories; the casting aside of petty commercial jealousies and rivalries by manufacturers who have freely interchanged trade secrets and patents; where management has been progressive and where labor has been intelligently led, labor and management have cooperated in many areas to get results; and, I like to believe, most importantly, there have been developed the twin techniques of internal auditing and industrial or management engineering. In a sense, these are interwoven in the first item mentioned, namely, developments in the art of management. However, both internal auditing and industrial engineering have shot to the forefront in prominence in the management field during the war period and, in recent years, in such a spectacular fashion as to over-shadow most developments in the area of management techniques. So I want to talk to you tonight about these two techniques as modernly conceived and practiced, and to point out just how they mesh together and make possible maximum production at lowest cost.

INTERNAL AUDITING

Let us look at internal auditing first. There is no question but that internal auditing, as modernly conceived and practiced, is suffering under a bad misnomer. Internal auditing is no longer the narrow checking operation it was in the past. Today, internal auditing is recognized as the examination of the functioning of an organization by one or more of the organization's own officers or employees for the purpose of determining wheth-

er or not established methods, policies, procedures, and practices are being followed, and whether they are being followed both effectively and efficiently.

Let us be clear on this point: Internal auditing is not auditing as usually understood. Auditing is usually understood to mean the science of verifying the records and reports which reflect the financial condition and operating results of a business.

Internal auditing, on the other hand, is a much broader activity. While auditing as generally understood—and as just defined—is one of the activities of the internal auditor, his work is not confined to just that. The internal auditor's job, in addition, embraces surveys of operations and personnel as well as the review of accounting and other data and records. In a fact, routine auditing is, in many instances, the least significant part of the internal auditor's work.

Only in the very recent past has internal auditing been recognized in its true light—as an arm of top management. Today, those who understand it, recognize it as a technique for providing top management with many important facts it would not otherwise have; for insuring adherence to budgetary standards; for securing observance of company policies; for establishing adherence to laws, regulations and contract terms by officers and down-the-line executives; for calling attention to the inadequacy of many types of physical property and to the lack of propriety in their use; for weeding out incompetent personnel and for highlighting talent; and for following up the work of the industrial engineer by seeing that new methods, procedures, and practices, once installed, are maintained.

Let me emphasize here that this description of internal auditing is not just theory. This is modern internal auditing as practiced by many of our leading corporations. This is modern internal auditing as recognized by men scientifically trained in management, men with whom rule-of-thumb managers will never catch up.

It is an established fact that chief executives trained in modern management methods expect the internal auditor to perform these functions for them:

ONE: Inform them of important facts;

TWO: See that policies established by the management are adhered to;

THREE: Ascertain that controls —managerial and accounting— are functioning properly; and

FOUR: Verify the accuracy of financial and statistical reports.

INDUSTRIAL ENGINEERING

Now turning to industrial or management engineering, let us first of all recognize that it is relatively new. While its roots go back to Harrington Emerson and Frederick Taylor—men of the last century — industrial engineering only began to grow with and after the last war and to increase progressively in stature during the expansive twenties and contractive thirties. It is my firm conviction that it will grow increasingly rapidly in importance from now on.

Industrial engineering owes its development to the application of scientific methods to business management and to the expansion in applied business research which followed the first world war. During the last few years, just as professional management engineering has grown in stature and become widely recognized and accepted as a principal tool for supplementing successful management, so too industrial engineering conducted within corporations has been experiencing a parallel growth.

Nathaniel W. Barnes, Executive Secretary of The Association of Consulting Management Engineers, has written a monograph on management engineering which is very helpful in understanding that activity. In it he states:

"... This young profession owes most to what is known as the 'scientific management movement.' ... Steadily the management engineer has broadened the scope of his work, until today it extends to all problems of business management. It includes not only the improvement of production and sales techniques, the development of financial and executive controls, and the review of management policies, but also consideration of such controlling factors and elements as: the structure of the administrative and operating organizations; the selection, training, direction and remuneration of personnel; the forecasting of demands and needs; the planning of activities and the budgeting of resources; the collection and maintenance, in the most economical way, of the most helpful control records relating to operating and distribution costs and results; the establishment of standards against which to measure progress in economy, in quality, and in service; the improvement of industrial relations; and the utilization of intelligent research and development procedures."

The duties of the company industrial engineer parallel closely the activities of the professional management engineer as described above. The duties of the company industrial engineer follow:

FIRST: To assist management in the solution of managerial problems by fulfilling the same role as

the company lawyer in the solution of legal problems, the controller in accounting problems, the aeronautical or other engineer in engineering problems, the cost accountant in cost problems, and so forth.

SECOND: To assist in developing and keeping up-to-date the organization structure of the executive, administrative and operating units of the company.

THIRD: To assist in developing, maintaining, reviewing, and controlling corporate policies.

FOURTH: To ascertain and activate ways and means of reducing expenses and eliminating waste.

FIFTH: To establish standards against which to measure progress in economy, quality, and service.

SIXTH: To simplify or otherwise improve equipment, procedures, and methods.

SEVENTH: To forecast the demands and needs of the company, to budget resources, and to assist management in the planning of its activities.

EIGHTH: To develop, review or maintain management controls when need for these arises; and to collect, interpret, digest, correlate and maintain the most helpful managerial control records.

NINTH: To ascertain that all essential activities are provided for, particularly as the business grows in size and complexity, and to make sure that responsibilities assigned to individual executives do not become too burdensome when such growth occurs.

TENTH: To assist management in the selection, coordination, and control of executive personnel.

ELEVENTH: To develop and maintain wage and salary incentive plans.

TWELFTH: To keep management informed, at all times, of the most advanced thinking on problems of managerial control, and to recommend ways and means of inaugurating new methods or techniques wherever these are applicable to the company's operations.

THIRTEENTH: To keep abreast of changes in managerial philosophies, and to devise and develop new management methods.

FOURTEENTH: To furnish necessary liaison with professional industrial engineering counsel on major management problems having broad scope or unusual aspects.

All of the foregoing are ways in which successful management can be supplemented by intracompany industrial engineering. These functions are important means for obtaining and maintaining control over costs, for establishing efficiency throughout all operations, for supplying top management with factual information, and for providing assistance in solving managerial problems.

Let us enlarge on the foregoing, since each is not readily under-

standable without some further discussion.

One of the important control media placed in the hands of the industrial engineer is the control over organization. Control over organization and organization structure is one of the oldest recognized forms of corporate control. Since organized problems relate to and dovetail with most industrial engineering responsibilities, it is logical to focus the responsibility for organization control in the industrial engineer. Closely tied to this matter or organization are such important matters as space and space layout, and executive personnel.

Also of great importance in controlling corporate activities are the ideals, objectives, and policies of the enterprise. These must be clearly stated, promulgated and understood if the most efficient and effective results are to be obtained. Again, centralization of this responsibility in the industrial engineer is logical because of its close relationship to other managerial control problems.

Of major importance is the methods engineering phase of industrial engineering. This has many facets, and some or all of these are found in some companies in divisions or departments bearing such titles as standards, work simplification, industrial engineering, methods, and the like. Methods engineering is a relatively new managerial technique not widely understood because of its comparatively recent development, particularly in relation to executive and administrative methods and procedures.

Let us define methods engineering as a technique that subjects each activity or related group of activities to close analysis in order to eliminate every unnecessary operation and in order to determine the quickest, cheapest and best method of performing each necessary operation.

Put another way, methods engineering is the means for establishing exact requirements as to facilities, machines, and manpower. By employing methods engineering techniques, determination can be made of space requirements, equipment requirements, time requirements, manpower requirements to carry on every given activity or related group of activities. Methods engineering includes procedure analysis, motion study, time study, setting up of factual bases for incentive purposes, and the like.

Standards are directly related to methods engineering. The organized use of scientifically determined standards, while of relatively recent origin, has become widely recognized as a valuable managerial tool. After studying each element of a man's work, each

machine, and each process or operation, and eliminating undesirable features, standards can be set up by which results can be measured and managerial control thereby established or bettered.

Simplification is still another result achieved through methods engineering. Simplification is applicable throughout the company to procedures, work methods, furniture, fixtures, office machines and other practices. Simplification necessarily precedes standardization.

Control over office and shop equipment is another responsibility of the industrial engineer. It has been found desirable in well-managed companies to focus in a central staff agency the responsibility for the review of the kind and quantity of new appliances, furniture, fixtures and other shop and office equipment to be purchased (not including technical equipment that only technically trained men are qualified to judge).

The foregoing discussion is not all-inclusive, but sufficient, I believe, to acquaint you with principal industrial engineering functions in a modernly organized corporation.

THE RELATIONSHIP BETWEEN INTERNAL AUDITING AND INDUSTRIAL ENGINEERING

The relationship between internal auditing and industrial engineering is this: both are major management control techniques. Not only that, but the work of one complements the work of the other. If you will permit me to oversimplify, the industrial engineer determines the one best way to perform a given function, and, with the corporate executive involved, establishes that one best way. It is then the duty of the internal auditor to see that the one best way is followed. In other words, the internal auditor polices the work of the industrial engineer. Without this policing, the industrial engineering work may not continue to be fully effective.

There is another major area where the work of the internal auditor dovetails with that of the industrial engineer. One of the primary goals of internal auditing is to call attention to inefficiency and waste. One of the primary goals of the industrial engineer is to eliminate inefficiency and waste. In other words, the duty of the internal auditor is disclosure, while that of the industrial engineer is solution. Where these complementary functions are properly correlated and harnessed together

as a team, the most far-reaching results can be achieved.

A principal function of the internal auditor is to appraise through the means of periodic surveys—to observe and disclose all faulty situations of whatsoever nature as they occur or are discovered. On the other hand, it is the job of the industrial engineer to correct these faulty conditions. That distinction in duties—between the duty of disclosure and the duty of correction—is of primary importance. Let us sum up as follows: the internal auditor is not responsible for developing remedial measures; the industrial engineer is.

In conclusion, I want to emphasize the importance to American Business of the new corporate techniques we have discussed tonight—industrial engineering and internal auditing. Where a company has inaugurated these activities, where proper reporting responsibility has been established, and where a good man has been placed in charge of an adequate staff, that company is in an enviable position to face the post-war transition era firm in the knowledge that production will be carried forward at high and efficient levels.

Neither you nor I would be realists if we failed to recognize that, with post-war adjustment, there are going to be many corporate casualties. Many companies are going to collapse into bankruptcy. In some instances, bankruptcy will be entirely due to a cessation of war demand, introduction of new and supplanting products, or other uncontrollable factors. However, in most instances, corporate failures will be due to poor management. And only poor managements will fail to recognize what industrial engineering and internal auditing could do for them.

The need for action now cannot be emphasized too strongly. Now is the time to establish efficiency and economy in your operations, not at some vague, future "V-Day." Now is the time to adjust your thinking to this fact: that your company may be knocked out of war production tomorrow. Now is the time to recognize that your company may be so laden down with war fat that it will waddle into bankruptcy unless that fat is trimmed off—and trimmed off soon.

As the new techniques of internal auditing and industrial engineering are tested in the crucible of everyday business life, it is believed that they will more effectively strengthen the structure of corporate management against attrition from internal neglect—strengthen management to such an extent that it can weather the worst foreseeable economic storms.

In coming before you tonight to talk of internal auditing and industrial engineering, I hope that I have brought you a few new thoughts. My hope is that by calling your attention to these new management techniques, they will become more generally acceptable and more widely adopted by you and by modern business management generally.

It is my hope and belief that by adopting these and other new management techniques, American Business can be made more efficient, that more jobs can be provided after the war, and that America can become an even more economically healthy nation to live in than it has been in the past.

ANNUAL INVENTORY

OF FIXED ASSETS*

By GORDON G. CROWDER

INTRODUCTION

SINCE accepting this assignment from your Program Chairman, considerable research, conversation and study has been devoted to the subject. This might be considered a controversial subject and one that should be treated with extreme care, but investigation developed that this is the right time for someone to present definite conclusions, from his own background of experience, on the subject of the Annual Inventory of Fixed Assets and then let other Internal Auditors judge for themselves as to whether their own house is in sufficiently good order to permit them to certify to the fixed asset section of their own balance sheets.

Before presenting the detailed story of the inventory of fixed assets, it might be well to mention a few of the benefits arising from such an inventory which cannot be recorded and priced in dollars. By assisting in taking of these inventories each year, the Internal Auditor is brought hand to hand and elbow to elbow with every part of the company's property. The Internal Auditor will find chairs with

*A paper presented before the Chicago Chapter on February 20, 1945.

squeaky backs and broken casters, and desks with rough edges that snag the girl's stockings. He will find out what makes the company "tick." The Auditors will learn the common language of the mine, the refinery, the foundry, the shop and the mill, and will become acquainted with those who operate the business, and obtain practical experience in its operation. This is executive training.

So, I suggest you listen to my story. I am sure you will, at least, be convinced that I am happy and proud of the part our Auditors have had in assisting in the taking of the actual inventory of fixed assets during the past seven years.

COVERAGE

Two of our Vice Presidents got together one day and agreed that instead of the Engineering Department being entirely responsible for the fixed assets, that the responsibility for these assets be shared by both the Engineering and Accounting-Auditing Departments. Right then is when our Auditing Department was assigned the job of taking a property inventory with the cooperation of the Engineering Department. The inventory covers all of our mines, shops, town sites, stores, restaurants, hospitals, retail yards, railroads and offices.

Our Vice President in charge of Finance and Accounting never accepts a responsibility without first ascertaining that it is one that should be accepted by the Accounting-Auditing Department, and when this responsibility is recognized, the problem is studied so that complete coverage will be obtained.

That is how simple it is for an Auditing Department to get into fixed asset inventories.

ORIGINAL PLANNING

We did not go into this work on a 50-50 basis either. We spread the base of responsibility so as to insure the success of the work. The distribution of the responsibility was made as follows:

1. To local Operating Departments was assigned the responsibility for the care of the property throughout the year and the institution of appropriate reports to permit.
2. The local Accounting Departments to maintain accurate records of the location of the property.
3. To the Field Engineering Departments was assigned part of the responsibility for taking the inventory and they continue to do the initial planning of new installations, etc.

4. To the Internal Auditors and District Field Auditors was assigned the responsibility for working with the Engineering Department in the taking of the inventory and analyzing discrepancies.

It has been said that Auditors are not Engineers and, consequently are not qualified to take such property inventories. To that I may say that competent Field Auditors who deal daily with the purchase and disbursement of supplies—also distribution of labor costs for capital expenditures as they are made—are capable of taking any kind of an inventory. It all depends on the background and training of the Field Auditors and we believe in taking them into the auditing force from the ranks of the local Accounting Departments and in some instances from the Operating and Engineering Departments.

Our initial planning included checking with all interested departments, to combine all of their requirements into a composite loose-leaf form of inventory sheet.

1. Local operating departments wanted enough information to permit them to order supply parts and show the remaining assigned life to each item, which is important in planning replacements.
2. Local accounting departments wanted enough blank space for notes needed for repair data and daily memos.
3. Division engineers wanted sufficient detail to permit hurried local transfers between plants as needed.
4. Main office engineers wanted a complete bound set of their own of each plant, on different colored paper, indexed, partly by location, and partly by kind of equipment. They became so interested, they prepared a very fine location index, applicable to all of our mines, shops and plants.
5. Main office accounting department wanted to provide for tools and other items, which, ordinarily, are expensed in order to keep good account of transfers of these items.
6. Last, but not least, other interested parties wanted complete, bound copies, to permit of their spot checking where cost plus contracts were involved.

PROCEDURES

Before starting the initial annual inventory, 3 x 5 cards were written for all property recorded in the property ledgers. These were sent to the various locations and checked with the property actually

in use. Many items were missing and other pieces of property were found on hand for which there was no record. Of the items missing, many were found at other mines and plants—having been hurriedly transferred at some previous time because of emergency created by a breakdown, or had been transferred to a shop for repairs. The items which checked "over" proved very interesting as well as tiring. They included stationary motors purchased with direct connected assemblies; sub-assemblies built up from spare parts, and last but not least, whole operating units which had been built from spare parts and charged to expense when the unit was badly needed but no authority for capital expenditure obtained. After this checking was completed, the sets of individual property inventory sheets were typed and returned to the main office for final checking, lifing, pricing and final assembly.

To make a long story short, many items were written off as property losses. Hundreds of transfer entries were necessary to record the actual location of property and many more hundreds of cards were necessary (as a record only) for tools and other small items previously charged to expenses.

It was not until the third annual inventory was checked at the plants and with the general property ledgers that we really had a property inventory in which we could take some pride and from which we could obtain some satisfaction.

Now the inventories are returned from the field with the following supplemental schedules attached. These schedules simplify the handling and show in full detail—

Schedule 1: Items "short" at this inventory.
Schedule 2: Items "over" at this inventory.
Schedule 3: Detail of spares.
Schedule 4: Items in inventory—not in use.
Schedule 5: Items on hand—written off, but not disposed of as scrap.

Only these schedules are priced for cost, depreciation and net value, and this is not a large job. When this work has been completed, the inventory is reviewed with the Chief Engineer of the company. At this conference, we passed on each schedule as follows:

As to Schedule No. 1—After thorough investigation, final authority is given to write off items found actually short, which have not turned up at some other property in the "over" items.

No. 2—Reasons are obtained for items over and proper accounting disposition is approved. Some cases bring out that items have been expensed when they should have been capitalized.

No. 3—Review of spares to see if they are excessive or in some cases sufficient.

No. 4—Action is taken to get into use, the inactive equipment from one plant to other plants where needed, or if not needed, an offer is made to sell to outsiders.

No. 5—Proper action is taken to clean up items written off but not previously sold.

When this is over each year, the slate is clean so far as property items are concerned.

MATERIAL RESULTS

What have we accomplished with these annual property inventories?

1. Better housekeeping and care of equipment.
2. Proper disposal of unused equipment.
3. Increased alertness and responsibility and sense of pride in local management for good recording of these items.
4. Elimination of many duplicate records for reference necessary to order spare parts.
5. Better initial records of new equipment and construction jobs.
6. Good local record, which is available for *spot check at any time by outside auditors.*
7. Better insurance coverage schedules, which are up to date at all times showing locations and amounts and conclusive record for claims when insurance losses occur.
8. Provides local management with depreciation rates which permit of their
   (a) Discussion of rates if they are not in accord with actual life, and to put some responsibility on them to
   (b) Justifying the continuing use of an item, in probable high cost operation, beyond its predetermined useful life.

9. Makes sure proper retirements are made on the company's books each year to coincide with action taken by local management.
10. Eliminates theoretical abstract discussions with outside auditors and others on depreciation and net property investment.
11. Last, but not least, it provides a solid foundation for determining the correct amount of Federal Income Taxes each year.

INDUSTRIES COMMITTEE SURVEY

A survey has just been completed by the Industries Committee of THE INSTITUTE OF INTERNAL AUDITORS for the purpose of ascertaining how property records are maintained and inventories taken, and the composite result of this survey has been made available for this presentation.

Mr. Bodman, Chairman of these various committees, will publish the complete survey in an early edition of "THE INTERNAL AUDITOR."

The questions asked were designed to receive "yes" or "no" answers, and you will find the information contained in this survey very interesting. Of course, you know the survey was confined to companies represented by our members.

Time permits of using only the composite result of the four questions particularly pertinent to our subject. I have reduced the answers to percent of affirmative or "yes" answers as reported in each of the nine industrial divisions, as in this way we can obtain a clear picture of the consideration that has been, and is being, given to the question of the Annual Inventory of Fixed Assets.

The first question was chosen because it shows how companies keep their property records. When they are kept on an "item" basis, it is much easier to take property inventories than when they are kept on a "composite" basis.

Question No. 1 was—

"*Are your property records on an 'item' basis?*"

The survey shows—

INDUSTRY GROUP	Percent of "YES" Replies to Question No. 1
Automotive	100%
Aviation	100%
Banks	80%
Foods—Beverages	81%
Metals—Coal	78%
Equipment—Mfgs.	90%
Petroleum—Chemical	75%
Public Utilities	77%
All Others	68%
AVERAGE 115 COMPANIES	80%

The next question used was No. 11—

"Does your company take physical inventory of Fixed Assets?"

The average of 67% was a very pleasant surprise to me, and probably will be to many others. Some companies that take such inventories only get around to them every five years, but they are taken—

INDUSTRY GROUP	Percent of "YES" Replies to Question No. 11
Automotive	100%
Aviation	100%
Banks	40%
Foods—Beverages	72%
Metals—Coal	63%
Equipment—Mfgs.	40%
Petroleum—Chemical	90%
Public Utilities	44%
All Others	63%
AVERAGE 115 COMPANIES	67%

The final two questions numbered 13 and 14 are still more interesting.

Number 13 is—

"Does Internal Audit Department enter into the taking of this inventory?"

Number 14 is—

"Do you think the Internal Audit Section should enter into active participation in such an inventory?"

The percent of affirmative answers is as follows:

INDUSTRY GROUP	Percent of Internal Audit Departments Who "DO"	Percent of Internal Audit Departments Who "Think They Should"
Automotive	100%	100%
Aviation	30%	85%
Banks	20%	60%
Foods—Beverages	36%	82%
Metals—Coal	26%	53%
Equipment—Mfgs.	10%	70%
Petroleum—Chemical	50%	60%
Public Utilities	16%	38%
All Others	26%	73%
AVERAGE	33%	64%

The automotive group is 100%. It is a fine record! The aviation group is good too—even if internal auditors do not participate in the majority of instances, but they are thinking along those lines.

The record points only one way—even though not perfect!

80% keep detailed property records.
67% take property inventories.
33% of internal auditors participate.
64% of internal auditors think they should.

If this presentation, and the result of the survey, will assist some company to make up its mind in favor of rounding out a complete internal audit control by including annual property inventories, they will have served a useful purpose!

The survey did not include financial figures showing the amount of fixed assets, gross and net, with the corresponding ratio of these to the total assets. Should you have a couple of hours some day, just take "Moody's Industrial Reports" and pick out one or two companies in each of the above industry groups and you will find the gross fixed asset or property account is from 15% to 119% of the total assets and the net property account after depreciation reserves, is from 7% to 70% of the total assets.

The fixed asset section of the balance sheet is important and 64% of our internal auditors believe they should participate in some regular inventory of it. You may very well wonder why only 64% of our Internal Auditors were of the opinion they should participate in some regular inventory of fixed assets. Internal auditing routine is in-

fluenced greatly by the Public Accountants and publicity given to advanced ideas. Each month, at our Chapter meetings, we hear of new functions being assigned to the Internal Auditor, the new arm of management. The *Third Annual Conference* of THE INSTITUTE OF INTERNAL AUDITORS this year was very inspiring and a great deal of thinking has been, and is being done within our organization to the end that auditing procedure will be broadened and improved. We members benefit from such meetings and others would become interested if our base of publicity was spread to the general business world and business schools.

Perhaps our colleges, universities, and night schools will soon realize that they have not fully informed their accounting and commercial students on auditing practices and procedures unless they are in constant touch with our organization, and unless they point out to their students that training in all-around fundamentals of business can best be obtained in an Internal Audit Department. Many alert schools have already prepared special courses in Internal Auditing with the assistance of our National Research Committee. Three members of our own Chicago Chapter are teaching at night in Chicago colleges. It is inspiring to see commercial schools endeavoring to keep their courses up to date in this manner. The point is that such procedures as the one about which I have been talking should be tested and if found practical and advantageous, should be publicized for the information of Management and Internal Auditors.

CONCLUSION

In conclusion, I would sum up this discussion by saying that Internal Auditors, if properly trained both in the main office and in the field, need have no fear of taking fixed asset inventories on joint basis with the Engineering, Operating and local Accounting Departments.

After a few complete inventories have been taken, pride in the accuracy of the inventories causes the work of each Department involved to be more accurate and many wonder why such inventories were not always taken just as other assets, such as cash, securities, accounts receivable, and merchandise on hand has been inventoried or audited.

All of us employ cashiers and auditors to handle various sized cash accounts—we throw controls around accounts receivables and notes and go to extended detail to verify them. We audit unexpired insurance schedules—we carfully take or check inventories of mer-

chandise and repair parts, and yet in most cases the value of these no more than equals the net depreciated value carried on fixed assets. So what is *the* logical and safe conclusion?

An annual inventory of fixed assets should be on the "required list" of all internal auditors.

This would be a valuable contribution to good auditing procedure and I feel sure that your outside auditors would approve of your adding this to your annual auditing program.

Simple Anglo Saxon words used here should not give anyone the impression that property inventories are simple assignments. However, they should be a challenge to every auditor and those who take on these blue chip assignments will thereby gain recognition of the other executive heads and be permitted to sit along-side in the inner councils of the company.

REPORT OF INDUSTRIES COMMITTEE

G. T. BODMAN, Chairman

FIXED ASSETS, ACCOUNTING AND INVENTORY PRACTICES

FOLLOWING is a summarization by Industries and in total of the replies received to the recent confidential survey. It was decided that the survey would not apply to Insurance Companies and Public Accountants; consequently, they are omitted from this report.

Your chairman is making no comment nor drawing conclusions from these replies, because he believes this should be reserved for the member who will shortly prepare an exhaustive and interesting paper on this subject.

The following statements are included in this report for the benefit of members and as subjects for Chapter discussions. The questions are listed in the Summary of Replies, which follows this report.

AUTOMOTIVE AND ALLIED INDUSTRIES

Question 1: All records show date of acquisition, equipment number, description, location, and cost.

All items as they become fully depreciated are removed from the Capital Asset Account and transferred to a memorandum control, and depreciation discontinued. Records of fully depreciated items are maintained in every respect the same as all items carried under Capital Assets with the exception they are not depreciated further.

Procedure for handling property records of equipment which is depreciated or amortized:

> As a general rule, all items of equipment are depreciated at a fixed or agreed upon rate based upon the estimated number of years of life or usefulness of the equipment. The original cost of the equipment is set up in a separate Capital Asset account according to classification. The amount of depreciation is set up in a separate account until the cost of the equipment is fully depreciated. Items of equipment of an investment nature which are to be amortized are set up in a Special Capital Asset Account, and this account is credited each month with the amount of amortization.

The representative of this industry, Mr. A. L. Simpson, Chrysler Corporation, 341 Massachusetts Ave., Detroit, Mich., submits the following questions which you are invited to answer direct to him:

How do YOU handle special items of equipment of an investment nature?

How do YOU handle dies, tools, jigs, fixtures and patterns? Do you depreciate these items monthly or determine the cost per finished product and establish an amortization rate?

Question 12: Inventories are taken at irregular intervals:

Question 13 and 14: Only to the extent of test checks.

Question 15: Responsibility for property inventories:

Engineering Department	— 25% to 60%
Local Accounting Department	— 60% to 100%

AVIATION

Question 3: One member points out that the inclusion of location data in the property records facilitates computation of departmental depreciation charges.

Question 14: Several members expressed belief that internal auditors should not assume primary responsibility for inventories but should confine their work to the review and appraisal of inventory procedures to

be used and to whatever observation and tests necessary to satisfy themselves that procedures adopted are followed in such a way as to obtain a satisfactory end result. One member points out that the auditor's tests should extend to listing a number of the items which he sees identified and counted in the field for eventual comparison with the adjusted property records. Another member points out that one of the benefits to be derived from good property records and good property inventories is the aid they will give in making final settlements with the Government for properties held under Defense Plant and other such contracts.

Question 15: Answers indicate that in most cases inventories are taken jointly by Plant Engineering and Accounting Departments. There was only one case reported where the internal auditors are primarily responsible for taking inventories, and only one case where an Operating Department is responsible for inventories to the exclusion of both Plant Engineering and Accounting Departments.

BANKS AND TRUST COMPANIES

It is the impression that most banks charge furniture and fixtures directly to expense and do not carry this item on their statements but depreciate these expenditures over a period of years for income tax purposes.

Responsibility for property inventories is allocated:

Operating Department	1 Company	— 50%
Internal Auditing Department	2 Companies	— 50%
Outside Appraisal	1 Company	— 100%
Procurement Department	1 Company	— 50%

One reply stated "In line with other Banks and Trust Companies, we charge equipment as purchased to expense. We capitalize only office premises and write off a proportion each year against profits."

Another company reports: "We do not have complete property records on desks, chairs, cabinets, etc., but do have complete records on machines. Records are more for service purposes than for inventory purposes."

FOOD, BEVERAGE, AND RELATED COMPANIES

Of the seven companies who replied in the affirmative on question fifteen, the composite average was:

Engineering Department	31%
Operating Department	11%
Local Accounting Department	29%
Internal Auditing Department	8%
Outside Appraisal Engineers	4%
Others	17%

IRON, STEEL, COPPER, COAL AND COKE COMPANIES

Question 1: One answer stated that no detail is kept on patterns, small tools, chills, and flasks.

Question 2: "We have found it useful to further subdivide the amortizable assets by Certificates of Necessity, thus having available totals subject to depreciation and to amortization and also by Certificate of Necessity."

Question 11: One negative reply stated: "Occasionally (about every two years) an inventory of rolling stock, trucks, carts, and movable machines is taken and compared with book figures."

Another: "While we do not take a physical inventory of fixed assets, we do feel fairly confident that we do get all retirements, losses, and junked equipment. This is policed in three ways: (1) Sales, (2) Periodic review of scrapped material before it is sold, (3) Motors reported installed on equipment which according to our records may be operating on equipment that has been scrapped.

Question 14: Because of a separate control of facilities department, this respondent's "Yes" applied only to spot checking. It is interesting to note that that department issues an authorization form in conjunction with budget program, which form is used for acquisition, movement, disposition, retirement, demolition or sale of fixed assets. In another case, the internal auditor makes spot-checks of inventory records with machines located in the particular department during audit.

Question 15: Of the affirmative answers, seven show participation in inventories, in whole or in part, with respective composite percentages:

	No.	Per Cent
Engineering Department	6	33
Operating Department	4	13
Local Accounting Department	8	30
Internal Auditing Department	4	10
Facilities Control Department	1	14

One reply stated that Operating Departments report to Accounting Department demolition, sale or transfer of assets.

Question 16: One member stated that property record sheets are arranged in strict numerical order by identity number by subaccounts; supplementing ledger record with tabulating card for each item, making it possible to obtain listings by location. These cards are also used to prove subsidiary property records monthly and to obtain depreciation and amortization charges for burden allocation.

MACHINERY AND EQUIPMENT MANUFACTURERS

Question 11: One company has had no inventory since an appraisal of 1934 but is now planning an annual inventory of furniture and fixtures only, the first of which will be taken by the internal auditors assisted by plant personnel. Another company answering "No" is contemplating a program of inventories once every four or five years.

Question 12: One company having no inventory program states that they do inventory property when it is deemed necessary.

Question 14: Two replies, classified as "Yes" state that auditors enter into inventory only to extent of test check and observation. One "No" answer is qualified by belief that auditor should do separate checking.

Question 15: Three respondents did not answer this question. The seven answers show the following participation in inventories in whole or in part with respective composite percentages:

Department	No.	Per Cent
Engineering	0	0
Operating	3	26
Local Accounting	4	19
Internal Auditing	1	7
Outside Appraisal Engineers	2	15
Others	3	33

PETROLEUM AND CHEMICAL COMPANIES

Property Record Department (composed of appraisers, accountants and clerical staff) maintains records and reports, property facts and figures for all accounting, cost accounting, insurance, taxation, compliance and other purposes; also it takes physical inventories. Internal Audit Department test checks property records and should observe inventorying occasionally.

Though it is recognized that internal auditors are not necessarily qualified to inventory technical or scientific equipment, it is believed they should make independent test verification to the same extent that material inventories are tested.

An orderly program of independent verification by physical inventory insures accuracy in the equipment and material records and promotes efficiency on the part of field personnel responsible for the custody of fixed assets and operating supplies.

In regard to equipment in use on producing properties: physical inventories are taken either during, or on completion of the development work in all *new* areas. In the more "settled" areas, physical inventories are taken at approximately two-year intervals, supplemented by intermediate spot checks. Miscellaneous equipment is checked annually.

Physical assets inventory schedule:

Manufacturing, Marketing, Geological, and Geophysical Department equipment.

Production Department:

Active partnership leases	Yearly
Active wholly owned leases	Every 2 years
Inactive partnership leases	Every 2 years
Inactive wholly owned leases	Every 3 years
Partnership pipe lines and gasoline plants	Every 2 years
Wholly owned pipe lines and gasoline plants	Every 3 years

There should be no question as to the need and importance of a periodical, thorough inventory of fixed assets, but very often the purpose of such a check-up is misunderstood. So long as a company maintains an adequate depreciation policy, there should be no great concern as to the possibility of over-stating the net assets

on the Balance Sheet of a Company. Nor should there be any great concern as to the pilfering of land or buildings, although the annual check-up should establish that where the Accounting Record indicates a certain building has been purchased or erected, it should be established such a building does in fact exist.

It is not generally realized the tremendous sum invested in movable items of equipment, especially, small tools which would be usable elsewhere. In this connection the real control gets back to the expenditures for replacement of missing and worn out equipment.

Every purchase of a new tool, whether charged to Expense or to Plant Account, should be preceded by a report stating the whys and wherefores and indicating what disposition has been or is to be made of the old item. This should be followed through for adjustment of the Plant Record where necessary and if an audit reveals that a great many adjustments in the Plant Record are needed this would indicate faulty operation in the requisitioning and purchasing of new equipment.

Six companies place full responsibility for property inventories with one department, namely: Property Records Department (1); Station Inspectors (1); Operating Department (1); Local Accounting Department (2). Only one company utilized Outside Appraisal Engineers and then only to the extent of 25 per cent. The seventeen "Yes" answers to question 15 show the following departmental participation in inventories, in whole or in part, with respective composite percentages:

	No.	Per Cent
Engineering Department	6	9
Operating Department	10	19
Local Accounting Department	11	33
Internal Auditing Department	7	14
Outside Appraisal Engineers	1	1
Others	6	24

PUBLIC UTILITIES

In some instances the "No" answer to Question 13 was qualified to the extent that the Internal Auditing Department did render supervisory service or did some spot checking during the course of the inventory.

The response of the membership to this general questionnaire is very encouraging; and it will be interesting to note if the possibilities of such interchange of practices and suggestions will stimulate interest within the respective industries to the extent that the representatives will shortly have questions before them for presentation to the individual groups.

You are aware of tendencies to discourage conventions for the duration; and if this should have any effect upon our Fourth annual conference, then certainly there should be an increased interest in the two mediums still available, namely: "The Internal Auditor" and the Industries Committee which will be valuable only to the extent to which you use them.

SUMMARY OF REPLIES — INDUSTRIES COMMITTEE SURVEY — PRO

QUESTIONS	Automotive and Allied Industries			Aviation			Banks and Trust Companies			Food, Ba age, and lated Co panie	
	Yes	No	#	Yes	No	#	Yes	No	#	Yes	No
1. Are your property records on an item basis?	6			7			4	1		9	2
2. Or on a subaccount or composite basis?		6			7		2	1	1	2	9
3. Do your records show location of items—i.e. building, room number, or operating zone?	6			7			4	1		9	2
4. Are your records used for insurable values?	6			7			4	1		10	1
5. Are they used for—fire damage claims?	6			7			4	1		9	1
6. —flood damage claims?	6			6		1	4	1		8	1
7. —windstorm damage claims?	6			6		1	4	1		8	1
8. —other insurance?	6			6		1	4	1		8	1
9. Are they used for ad valorem tax rendition?	6			6		1	2	3		6	5
10. Are you sure from your records that all allowable deductions are being made on your Federal Income Tax returns for retirements, losses, and junked equipment?	6			5	1	1	5			11	
11. Does your company take physical inventory of fixed assets?	6			7			2	3		8	
12. If so, at what intervals											
Semi-annual				1							
Annual				2						4	
Two Years											
Three Years				1						1	
Five Years											
Continuing				1			1			3	
Varying	6			2			1				
No Answer											
13. Does Internal Audit Department enter into the taking of this inventory?	6			2	5		2	1	2	4	
14. Do you think the internal audit section should enter into active participation in such inventory?	6			6	1		3	1	1	9	
15. In your company are there other departments assuming responsibility in property inventories?	6			5	1	1	3	2		7	
16. Are your inventory sheets or cards indexed locally by location to facilitate inventory work?	6			6		1	2	1	2	6	
Number of Replies	6			7			5			11	

#—No answer or inapplicable.

PROPERTY RECORDS AND INVENTORIES OF PROPERTIES

Food, Beverage, and Related Companies			Iron, Steel, Copper, Coal, and Coke			Machinery and Equipment Manufacturers			Petroleum & Chemical Companies			Public Utilities			Miscellaneous Companies			Total		
Yes	No	#	Yes	No	#	Yes	No	#	Yes	No	#	Yes	No	#	Yes	No	#	Yes	No	#
9	2		15	4		9		1	15	5		14	3	1	13	4	2	92	19	4
2	9		7	12		3	6	1	5	7	8	3	14	1	9	3	7	31	65	19
9	2		17	2		9		1	18	2		15	2	1	13	5	1	98	14	3
10	1		10	9		10			17	2	1	15	3		14	3	2	93	19	3
9	1	1	12	6	1	7		3	16	3	1	15	3		10	5	4	86	19	10
8	1	2	11	6	2	6		4	15	4	1	15	3		9	6	4	80	21	14
8	1	2	11	6	2	7		3	16	3	1	15	3		9	6	4	82	20	13
8	1	2	10	6	3	7		3	13	6	1	15	3		10	5	4	79	22	14
6	3	2	6	10	3	6	2	2	14	3	3	13	4	1	10	5	4	69	30	16
11			16	2	1	8	1	1	19		1	15	2	1	13	4	2	98	10	7
8	3		12	6	1	4	5	1	18	2		8	9	1	12	6	1	77	34	4
			2						1						1			5		
4			5			1			5			3			4			24		
									1						2			3		
1									2									4		
			1						2									3		
3												2						7		
			4			3			7			3						26		
															5			5		
4	7		5	7	7	1	5	4	10	10		3	10	5	5	10	4	38	55	22
9	2		10	2	7	7	2	1	12	8		7	7	4	14	3	2	74	26	15
7	4		13		6	6	3	1	17	2	1	10	4	4	11	6	2	78	22	15
6	5		12	1	6	6		4	17	2	1	10	1	7	10	5	4	75	15	25
11			19			10			20			18			19			115		

BIOGRAPHY OF AUTHORS

WHOSE ARTICLES APPEAR IN THIS ISSUE

JOHN B. THURSTON, author of "Modern Internal Auditing and Its Relationship to Industrial Engineering" is Treasurer and Director of Industrial Engineering in Transcontinental and Western Air, Inc. He holds the degrees of A.B. from Williams College and LL.B. from New York Law School. He is a lawyer admitted to the New York and Federal Bars and a Certified Public Accountant of the State of New York. He was one of the founders and first President of THE INSTITUTE OF INTERNAL AUDITORS and is a member of the National Association of Cost Accountants and Controllers Institute of America. He was author of THE INSTITUTE's first book "Internal Auditing; A New Management Technique" and has written articles which have appeared in The Journal of Accountancy and other publications. Prior to joining Transcontinental and Western Air, Inc., he was Assistant to the Comptroller and Internal Auditor, Fram Corporation. Previously, he had been Internal Auditor of The North American Company. Before joining the latter company, he was on the staff of R. G. Rankin & Co., C. P. A.'s.

T. C. DAVIS, author of "The Internal Auditor's Contribution to Corporate Tax Problems" is Assistant Treasurer in charge of the Treasury Division of E. I. du Pont de Nemours & Company. He is a Certified Public Accountant of the State of Delaware, and holds the degrees LL.B. and J.D. He is a member of the Controllers Institute of America and of the Delaware State Society of Certified Public Accountants. He is also an associate member of the American Institute of Accountants and of the New York State Society of Certified Public Accountants.

GORDON G. CROWDER, author of "Annual Inventory of Fixed Assets" is Assistant to the Vice President in charge of Finance and Accounting of Peabody Coal Company, Chicago, Ill. Mr. Crowder attended the Uinversity of Wisconsin Chemical Engineering School and the Walton School of Commerce.

After serving two years in the Operating Department of Peabody Coal Company, he was transferred to the Accounting Department, serving in various capacities, in-

cluding that of Traveling Auditor, and in 1925 was appointed Auditor in Charge of Mine Accounting. While employed in this capacity, he assisted various accounting firms in the installation of cost systems in coal mines and other industries, and did senior work on audits and examinations.

In 1931 Mr. Crowder served as Technical Accounting Advisor on Hugh Johnson's Committee, which Committee developed the present uniform cost system for the Bituminous coal industry.

At present, Mr. Crowder is Chairman of the Special Tax Committee of the National Coal Association, a Director of THE INSTITUTE OF INTERNAL AUDITORS, and a Trustee of the Loring School of Chicago.

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Chapter	January 31, 1945	September 30, 1944
Chicago	59	56
Cleveland	34	25
Dayton	17	14
Detroit	73	70
Los Angeles	70	63
New York	175	171
Philadelphia	40	36
Toronto	27	21
Non-Chapter	119	100
Total	614	556

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